LETTER OF TRANSMITTAL

STATE RETIREMENT AND PENSION SYSTEM OF MARYLAND
STATE RETIREMENT AGENCY

120 EAST BALTIMORE STREET
BALTIMORE, MARYLAND 21202
TELEPHONE: 410-625-5555
1-800-492-5909

THOMAS K. LEE
EXECUTIVE DIRECTOR
TO THE BOARD
BOARD OF TRUSTEES

December 15, 2003

Honorable Chairman & Members of the Board of Trustees:

We are pleased to submit the Comprehensive Annual Financial Report for the State Retirement and Pension System of Maryland (the "System") for the fiscal year ended June 30, 2003. We believe this report fairly reflects the results achieved during 2003.

The System is charged with the fiduciary responsibility for properly administering the retirement and pension allowances and other benefits, while striving to keep employer contribution rates as affordable as possible while maximizing investment returns and minimizing the risks inherent in any investment program. Members covered by the plans include State employees, teachers, law enforcement officers, legislators, judges, as well as local government employees and fire fighters whose employers have elected to participate in the System.

Seventy-six years ago, the first statewide retirement plan in Maryland (the Teachers' Retirement System) was established. Fourteen years later, in 1941, the Employees' Retirement System was established. Together these two plans comprise the majority of the System's membership. The System now provides monthly allowances to more than 90,000 retirees and beneficiaries, and is an essential element of the future financial security for over 190,000 active participating members. Descriptions of the membership requirements of, and benefits provided by, each plan administered by the System are included in the Plan Summary Section starting on page 85.

This Comprehensive Annual Financial Report contains six sections. The Introductory Section includes this letter of transmittal, along with information about the administrative structure of the System. The Financial, Actuarial and Investment Sections provide a comprehensive review of the System's financial position, the results of its operations and its funded status. Viewed separately, each of these three sections provides information about a different aspect of the System's long-standing record of stewardship and financial stability. In this regard, the Financial Section contains the report from the System's independent auditor, the combined financial statements and supplementary financial data. The Actuarial Section contains the independent actuary's certification, as well as the results of the System's annual actuarial valuation. The Investment Section includes a report from the System's Chief Investment Officer highlighting the past year's performance in addition to various summary level portfolio composition and performance data. The Plan Summary and Statistical Sections provide detailed descriptions of the various plans' provisions and the demographic composition of the membership segments affected by each plan.

In addition to this Letter of Transmittal, additional narrative, overview and analysis can be found in Management's Discussion and Analysis found on pages 15 through 19 of this annual report.

Economic Environment

As was the case during fiscal years 2001 and 2002, the lackluster economic environment during the first part of fiscal year 2003 presented another significant challenge to public pension funds. A recovery in the latter part of the fiscal year allowed the System to have positive investment returns for the first time in the last 3 years; however, those returns were still below the System's actuarially determined target investment return for fiscal year 2003 of 8.0%. As such, the System had a decrease in its overall funded status for the third year in a row. Despite this temporary downturn, the System remains financially strong and ahead of schedule with regard to its long-term funding goals.

Investment Strategies

Under the experienced direction of its Board of Trustees, the System plans to continue following its steady course toward maximizing investment returns while minimizing its exposure to risk. In the months ahead, the System will continue to deploy assets at home as well as throughout the expanding global markets in an effort to maintain an appropriate portfolio balance.

Major Issues and Initiatives

The System contracted with an investment consultant to perform a review of the asset allocation policy. As a direct result of the consultant's recommendations, the Board of Trustees made substantial changes in its asset allocation and investment manager structure during this past fiscal year.

Working to improve the public confidence in corporate governance, the Board of Trustees has stepped up its efforts to advocate for governance reforms. Details of the governance reforms, as well as details of the consultant's recommendations, can be found in the Chief Investment Officer's Report on pages 42 through 44.

Financial Information

Because System management is responsible for the information contained in this report, we have committed the resources necessary to maintain an internal control structure which provides reasonable assurance that assets are adequately safeguarded and the financial records are consistently and accurately maintained. Accordingly, we are confident that the financial statements, supporting schedules and statistical tables included in this report fairly present the System's financial condition and the results of its operations in all material respects.

Accounting System and Reports

The System reports its transactions on the accrual basis of accounting, under which revenues are reported in the accounting period in which they are earned and become measurable and expenses are reported when the related liability is incurred. Investments are reported at fair value at fiscal year end. Investment purchases and sales are reported in the accounting period in which the related trade dates occur.

Revenues

The reserves necessary to finance retirement allowances and other benefits are accumulated through investment earnings and the collection of employer and member contributions. During fiscal year 2003, investment earnings were $799 million, while revenues from employer and member contributions were $601 million and $208 million, respectively. For fiscal year 2003, member contribution rates remained unchanged, while employer rates varied depending on the System.

Expenses

The System's expenses consist of monthly retirement allowances, refunds of contributions to terminated and transferring members and withdrawing employers, and the administrative cost of System operations. As expected, payments to retirees, beneficiaries and transferring or withdrawing members and employers continued to be the System's primary disbursements during 2003, totaling $1,491 million. Of this amount, the System disbursed $1,474.3 million as retirement allowances to members and beneficiaries. The remaining $16.3 million was paid to members and withdrawing employers as a result of employment terminations, system transfers or withdrawal. Administrative and investment expenses are entirely funded through investment income. Of the $94 million disbursed during fiscal year 2003 to manage the investment portfolio and to administer the System, $73 million was paid for investment management, portfolio custody and securities lending services while $21 million was used to fund the System's administrative operations.

Funding and Reserves

Funds, derived from the excess of revenues over expenses, are accumulated by the System in order to meet benefit obligations to both current and future retirees and beneficiaries. The Annotated Code of Maryland requires participating employers to make periodic contributions which, as a level percentage of payroll, will fund the employers' "normal costs" over the members' average active service period, and the System's accrued unfunded liability in separate annual layers. Specifically, the unfunded actuarial liability that existed at June 30, 2000 will continue to be amortized over the remaining 17-year period to June 30, 2020, whereas each subsequent annual liability layer will be amortized over a 25-year period. Each year the Board of Trustees certifies the required employer contribution rates based on the actuary's annual valuation and recommendations.

At June 30, 2003, the System's actuarial accrued liability was $35.0 billion. With the actuarial value of assets accumulated to pay the liability at $32.6 billion, the System now stands at 93.3 percent funded.

Investments

The System engaged in a restructuring of the investment portfolio during the latter part of the fiscal year. The restructuring consisted of a reallocation of $1.3 billion from internally managed U.S. Treasuries into a corporate bond index fund and a corresponding reallocation of invested funds from international stocks into U.S. Treasuries. Although the domestic equity markets began to recover in the latter part of the fiscal year, they had an overall decrease for the 3rd consecutive fiscal year. Overall, investment performance in fiscal year 2003 improved over the prior two fiscal years as the System realized a 3.2% investment rate of return during the fiscal year.

Professional Services

The System contracts for the services of various independent consulting, investment advisory and financial professionals to assist the Board of Trustees in carrying out its fiduciary responsibility to efficiently and effectively manage the System. For example, actuarial services were provided by Milliman USA and independent financial statement audit services were provided by the State of Maryland's Office of Legislative Audits. The System's asset custody and portfolio accounting services are provided by the State Street Bank & Trust Company under a multi-year, master custody arrangement. A complete listing of the System's professional consultants and external investment advisors is presented on page 11.

Certificate of Achievement
for Excellence in Financial Reporting

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the State Retirement and Pension System of Maryland for its comprehensive annual financial report for the fiscal year ended June 30, 2002. This was the fourteenth consecutive year (1989 through 2002) the State Retirement and Pension System of Maryland has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

Acknowledgments

This annual report reflects the dedicated efforts of the System's staff under the steady direction of the Board of Trustees. We extend our sincere gratitude to each member of the Board of Trustees, the Agency's staff, the Board's advisors and the many people who worked so hard to make fiscal year 2003 a success.

Thomas K. Lee
Executive Director &
Secretary to the Board

Margo M. Wheet, CPA
Chief Financial Officer

STATE RETIREMENT AND PENSION SYSTEM OF MARYLAND
STATE RETIREMENT AGENCY

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THOMAS K. LEE
EXECUTIVE DIRECTOR
TO THE BOARD
BOARD OF TRUSTEES

December 15, 2003

Dear Members and Beneficiaries::

A positive investment environment returned to the financial markets in fiscal year ending June 30, 2003. Total investment return of the Maryland Retirement and Pension System (SRPS) was a positive 3.2% compared with a negative 7.6% for fiscal 2002. Total fund assets were $26.7 billion at the close of fiscal 2003 versus $26.6 billion in 2002.

Much progress at SRPS has taken place during the fiscal year. In last year's letter, we committed ourselves to an aggressive five-point program needed to address difficult issues facing the Agency. This is to report on that effort.

Specifically, a new strategic investment strategy has been implemented, new governance and administrative policies have been adopted, and a highly qualified and experienced investment professional has joined our senior staff team as Chief Investment Officer. The membership of the Board of Trustees now includes a number of appointed professionals with investment background. We believe we are now a stronger organization as a result of these additions and more capable of handling the challenges faced by us and most public pension funds.

The Board of Directors wishes to express its appreciation for the support and confidence that you have shown during the past year. It is our intention to continue to communicate openly to all members and beneficiaries regarding investment and administrative issues through the newsletters and web site. Should you have any concerns please feel free to call our toll free number 1-800-492-5909 or e-mail us at sra.state.md.us or write to the address on the back cover. Please be assured your inquiries and comments will be reviewed promptly. SRPS welcomes your input and wants to affirm that your benefits are safe and secure.

While we realize much work lies ahead, we are pleased with the progress to date and believe you should be also. Our strategic direction is correct and SRPS will continue to pursue its program with a sense of urgency and a goal of excellence in all that we do.

Sincerely,

William Donald Schaefer

WILLIAM DONALD SCHAEFER
Chairman

Nancy K. Kopp

NANCY K. KOPP
Vice Chairman

BOARD OF TRUSTEES

WILLIAM DONALD SCHAEFER, *Chairman*
State Comptroller
Ex Officio since January 25, 1999
Member, Investment Committee
Member, Real Estate Subcommittee

NANCY K. KOPP, *Vice Chairman*
State Treasurer
Ex Officio since February 14, 2002
Member, Investment Committee
Member, Executive Committee
Member, Audit Committee

WILLIAM D. BROWN
August 1, 1997 – July 31, 2005
Chairman, Executive Committee
Member, Audit Committee

ARTHUR N. CAPLE, JR.
August 1, 1985 – July 31, 2005
Chairman, Investment Committee

JAMES C. DI PAULA
Ex Officio since January 15, 2003
Member, Executive Committee
Member, Investment Committee
Member, Audit Committee

DR. NANCY S. GRASMICK
Ex Officio since September 16, 1991
Member, Executive Committee

DAVID B. HAMILTON
July 1, 2003 - June 30, 2007
Member, Executive Committee
Chairman, Audit Committee

KENNETH C. HOLT
August 1, 2003 - July 31, 2005
Member, Investment Committee

BOARD OF TRUSTEES

MAJOR MORRIS L. KROME
August 1, 1998 – July 31, 2006
Vice Chairman, Executive Committee
Member, Audit Committee
Member, Investment Committee

CARL D. LANCASTER
August 1, 1987 – July 31, 2007
Vice Chairman, Investment Committee
Chairman, Real Estate Subcommittee

DR. A. MELISSA MOYE
July 1, 2003 - June 30, 2007
Member, Investment Committee
Member, Real Estate Subcommittee

PATRICK A. O'SHEA
July1, 2003 - June 30, 2007
Member, Investment Committee
Member, Real Estate Subcommittee

PUBLIC ADVISORS TO THE INVESTMENT COMMITTEE

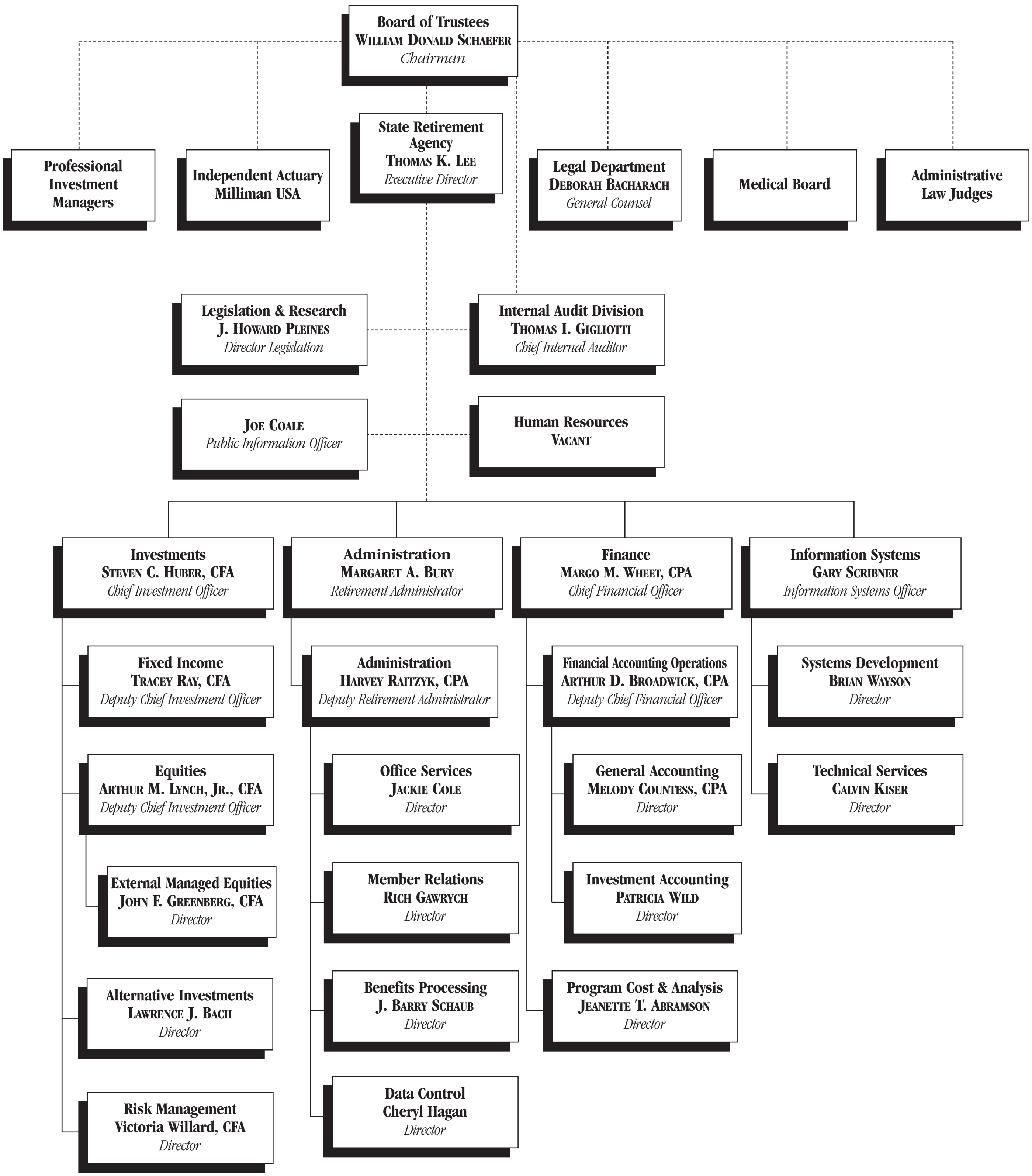
ROBERT W. SCHAEFER

WAYNE H. SHANER

BRIAN B. TOPPING

ORGANIZATIONAL CHART

(November, 2003)



PROFESSIONAL SERVICES

Asset & Income Verification Services

Financial Control Systems, Inc.
Chadds Ford, Pennsylvania

Equity Investment Managers

Abbott Capital Management, LLC
Boston, Massachusetts

Adams Street Partners, LLC
Chicago, Illinois

Advent Capital Management
New York, New York

Ariel Capital Management, Inc.
Chicago, Illinois

Bank of Ireland Asset Management Limited
Dublin, Ireland

Brown Capital Management, Inc.
Baltimore, Maryland

Brown Investment Advisory & Trust Company
Baltimore, Maryland

Capital Guardian Trust Company
Washington, D.C.

Dimensional Fund Advisors, Inc.
Santa Monica, California

The Edgar Lomax Company
Springfield, Virginia

HarbourVest Partners, LLC
Boston, Massachusetts

Legg Mason Capital Management, Inc.
Baltimore, Maryland

Maryland Venture Capital Trust
Baltimore, Maryland

Relational Investors, LLC
San Diego, California

Robert W. Torray & Co., Inc.
Bethesda, Maryland

State Street Global Advisors
Boston, Massachusetts

T. Rowe Price Associates, Inc.
Baltimore, Maryland

Templeton Investment Counsel, Inc.
Fort Lauderdale, Florida

Trust Company of the West (TCW)
Los Angeles, California

Fixed Income Investment Managers

Fountain Capital Management, LLC
Overland Park, Kansas

Lazard Asset Management
New York, New York

Morgan Stanley Dean Witter Investment Management
West Conshohocken, Pennsylvania

Pacific Investment Management Company
Newport Beach, California

State Street Global Advisors
Boston, Massachusetts

W. R. Huff Asset Management Co. LLC
Morristown, New Jersey

Global Custodial Bank

State Street Bank and Trust Company
Boston, Massachusetts

Hearing Officers

Office of Administrative Hearings
Baltimore, Maryland

Independent Actuary

Milliman USA
Baltimore, Maryland

Independent Auditor

Office of Legislative Audits
Baltimore, Maryland

Independent Investment Consultant

Ennis Knupp & Associates
Chicago, Illinois

Medical Board

John J. Fahey, M.D.
Norman Freeman, Jr., M.D.
Arthur Hildreth, M.D.
Bruce Z. Kohrn, M.D.
William B. Russell, M.D.
Claudia Thomas, M.D.
Alfred Wiedmann, M.D.

Operational Banking Services

M & T Bank
Baltimore, Maryland

The Harbor Bank of Maryland
Baltimore, Maryland

Real Estate Investment Managers

Chesapeake Maryland Limited Partnership
Baltimore, Maryland

J.P. Morgan Investment Management, Inc.
New York, New York

LaSalle Investment Management, Inc.
Baltimore, Maryland

LaSalle Investment Management Securities, LP
Baltimore, Maryland

Lubert-Adler Management, Inc.
Philadelphia, Pennsylvania

TimesSquare Real Estate Investors
Hartford, Connecticut

Certificate of Achievement for Excellence in Financial Reporting

Presented to

State Retirement and Pension System of Maryland

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2002

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.